



MINISTRY OF AGRICULTURE, FISHERIES AND FOOD
WHITEHALL PLACE, LONDON SW1A 2HH

From the Minister
CONFIDENTIAL

Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON
SW1P 3AG

Prime Minister

*To note. Subject to the
Chancellor's views, the proposed
1 1/2 p per pint for*

16 May 1979

RETAIL AND WHOLESALE MILK PRICES

I find we have inherited from the Labour Government a difficult situation in relation to the retail and wholesale prices of milk. This has been made more serious by the delay in taking action. Unless action is taken now, there will be a serious reduction in returns for both producers and distributors of milk. I am therefore writing to seek your urgent agreement to the price changes which need to be made.

When announcing the present retail price of milk, John Silkin indicated that, "short of a natural disaster", no further retail price increase would be necessary until next autumn. But this assumed that wage increases would be kept within the Labour Government's guide-line, whereas in practice the milk processing and distribution industry agreed wages of over 15%. The additional cost of this extra 10% on wages is about £55 m, which is equivalent to the extra revenue generated by adding 1 1/2p per pint to the price of milk over a four month period. We shall therefore be able to demonstrate quite clearly that the need to make the increase now, rather than in the autumn as John Silkin prophesied, is entirely due to the wage settlements.

After the ending of the milk guarantee at the end of 1977, the Labour Government introduced new pricing arrangements for liquid milk under which the Government sets the distributive margin (the gap between the retail price and the wholesale price) at such a level as to reimburse the dairy industry for the expected average costs of processing and distributing liquid milk in the forthcoming six-month period (together with any adjustments to take account of variations in costs from those expected in earlier periods), plus a fixed rate of profit. My officials' calculations - which so far as processors' and distributors' costs are concerned are based upon independent costings investigations, and which have been discussed with the interests concerned and with officials in other

departments - show that on this basis the distributive margin ought to have been increased by about 1.9 pence per litre (ppl) (or about 1.1 pence per pint) from 1 April. But no change was made and, if the distributors are now to be able to get what is due to them by the end of September, the distributive margin in England and Wales needs to be increased by 2.97 ppl for the four months from 1 June.

So far as producers are concerned, the present wholesale price in England and Wales (the price paid to the Milk Marketing Boards by the dairy companies for milk to be sold on the liquid market) is 13.274 ppl. If the margin increase discussed above were to be made without any change in the retail price, the wholesale price would be cut drastically, to a level which would be below the price of milk for butter going into intervention. This would have serious consequences for marketing but even more serious ones for producers.

If, for instance, we were to keep the retail price at its present level until March 1980 producers' net margins would fall from £99 to £50 per cow in 1979/80, 55% lower in real terms than in 1978/79 and 72% lower than the relatively good year of 1977/78. It needs an increase in the retail price from the beginning of June of 1½p per pint (2.64 ppl) to bring producers' net margins up to a reasonable level and even this would only achieve an estimated £103 per cow for 1979/80, still 6% in real terms below 1978/79 which was a relatively poor year. (These figures incidentally assume no increase in the EEC co-responsibility levy: if the levy were to be raised to 2% from July the net margin would be reduced by about £7 per cow.) In this connection, I should stress the vital position which milk production occupies in agriculture. It is important not only for its own sake but for the fact that two thirds of our supplies of beef come from the dairy herd. I find dairy farmers' confidence at a critical point after their very difficult winter and, if we do not act quickly, I fear that the whole industry will begin to doubt the strength of our commitment to ensuring the health of farming.

In the light of these considerations - my conclusion is that we must increase the retail price of milk by 1½p per pint from 3 June (the first Sunday in the month) and stand ready to look at the position again later in the year to see whether any further adjustments are necessary. The alternative of a smaller increase now, of 1p per pint, would mean that a further increase of 1p per pint would be necessary in the autumn, and even then producers' returns would be well short of last year's level. And a devaluation of the green pound is of little help here since a 5% change would add only £3 per cow to producers' margins in 1979/80.

There are, of course, disadvantages in increasing the retail price by 1½p per pint. The first concerns the attitude of the distributive industry, who are likely to be critical of such an increase because of the possible adverse effects on sales. But it is a fact that the 1p per pint increase made in November has had little if any effect on consumption and, especially in view of the recent rate of wage increases and the expectation of tax reductions, I would hope that the increase now proposed would have an equally small effect. Secondly, consumers will be critical, particularly bearing in mind John Silkin's undertaking last autumn, but we should be able to make it clear that the increase is necessitated by wage and cost increases which took place under the last Government. Finally, we need to consider the possibility of liquid milk imports. Certainly we may in future need to watch out for the effect of price increases

on imports, especially of packaged milk; but for the moment our health regulations protect us in this area and I am confident that we can retain these at least until the end of the year. (I would point out, however, that even after this increase the prices received by our milk producers would be lower than the target price for milk set for the EEC.)

So far as Northern Ireland is concerned, corresponding examination of processing and distribution costs indicates that the retail price should be increased by the same amount as in England and Wales and the wholesale price reduced by slightly more. In Scotland, the position is complicated by the fact that the costings figures are not yet available and that a preliminary assessment shows that distributive costs there may not have increased by quite as much as in the rest of the UK. To deal with this discrepancy, George Younger and I are agreed that we should follow the precedent established last November (when a similar position arose) and delay the price increase in Scotland for a short period, ie until 15 July. In principle however neither George Younger nor myself feel that it is right to have different retail prices in different parts of the UK - even for relatively short periods. We are therefore agreed that we should move on to a combined costings and price system as soon as possible, and I understand that DANI would wish that Northern Ireland too should be included in this. I am therefore asking my officials, in consultation with officials from the other agricultural departments, to consider how best this could be done and to report to me. I shall also be taking this opportunity of looking into all the costings arrangements and the whole of the present system of milk pricing. When I have been able to do this, I shall let my colleagues have the results of my consideration, together with my proposals for future action.

In the light of the above I should be grateful for your early agreement to:

- (1) an increase in the retail price of milk of $1\frac{1}{2}$ p per pint on 3 June in England and Wales and Northern Ireland;
- (2) an increase in the retail price of milk in Scotland of $1\frac{1}{2}$ p per pint on 15 July;
- (3) suitable corresponding adjustments to the wholesale prices in the different countries on 1 June.

I am copying this letter to the Prime Minister, John Nott, George Younger, Nicholas Edwards, Humphrey Atkins and Sir John Hunt.

I do not believe such a large increase is possible politically. It is a pre-announced item in the budget. I p. 5 all the will be reason is the other political issues - I do wonder when could it be done!

Further I can't see would hide the author's reasons for new rules etc

PETER WALKER